

MARATHON OIL CO.

IBLA 85-934

Decided May 25, 1988

Appeal from a decision of the Eastern States Office, Bureau of Land Management, conditioning the termination of nationwide oil and gas lease bond Nos. 554979-1 and 6024496 on the acceptance of certain conditions.

Reversed and remanded.

1. Oil and Gas Leases: Bonds

Under 43 CFR 3104.5, BLM has authority to increase the amount of coverage required of any surety bonds of an oil and gas lessee or operator when additional coverage is deemed appropriate. However, a BLM decision increasing the coverage will be reversed where the increase is based on a higher minimum set out in proposed regulations, or on an asserted underpayment of royalties when the Department admits in other litigation that the lessee has in fact overpaid the royalties.

2. Oil and Gas Leases: Bonds

BLM may terminate the requirement to hold an oil and gas lease surety bond when an oil and gas operator has fulfilled all the lease terms and posted an acceptable alternative bond.

APPEARANCES: Kirby J. Iler, Esq., Hugh V. Schaefer, Esq., and George H. Rothschild, Jr., Esq., Findley, Ohio, for Marathon Oil Company.

OPINION BY ADMINISTRATIVE JUDGE KELLY

Marathon Oil Company (Marathon Oil) appeals from a decision of the Eastern States Office, Bureau of Land Management (BLM), dated August 15, 1985, which provided for certain conditions as a prerequisite to the release of nationwide oil and gas lease bond Nos. 554979-1 (Marathon Petroleum Company, principal) and 6024496 (Husky Oil Company, principal).

In a January 20, 1984, letter, Marathon Oil requested that BLM permit it to cancel surety bond No. 554979-1. That bond was issued by the Ohio Casualty Insurance Company on January 8, 1952, on behalf of the Ohio Oil Company. ^{1/} According to that letter, a corporate reorganization of USS Holdings Company and its wholly owned subsidiary, Marathon Oil Company, was effected in July 1982. USS Holdings Company was renamed Marathon Oil and the original Marathon Oil Company was renamed Marathon Petroleum Company (Marathon Petroleum). Thus, the holding company became "Marathon Oil Company" and its wholly owned subsidiary became "Marathon Petroleum Company." On July 10, 1982, the principal of bond No. 554979-1 was amended to "Marathon Petroleum Company" to reflect this change in title. On August 24, 1982, the new Marathon Oil acquired blanket nationwide oil and gas bond No. 2279791. According to appellant, as part of the corporate restructuring, Marathon Petroleum assigned all Federal oil and gas leases and other rights to the holding company, the new Marathon Oil. In its letter, appellant states Marathon Petroleum

does not currently own any interest in Federal oil and gas leases, operating rights or rights-of-way, nor does it have any intention of acquiring such in the foreseeable future. Accordingly, we are hereby requesting written approval to cancel the nationwide oil and gas lease bond of Marathon Petroleum Company. This will, of course, not affect the bond of Marathon Oil Company, the holder of all Marathon Petroleum Company's former Federal interest, which will remain in full force and effect.

By letter to Marathon Oil dated July 30, 1984, the Colorado State Office (CSO) recognized the merger of Husky Oil Company (Husky) into Marathon Oil. Apparently, in response to a request by Marathon Oil that it be granted permission to release the nationwide oil and gas lease bond held by Husky, the CSO replied:

Termination of the bond might be more feasible if the current bond for Marathon Oil Company, filed in the Eastern States Office, were modified by adding the exploration rider and an additional rider assuming all outstanding liability on Bond No. 60 24 496 in consideration for the release of the present Husky bond.

As an alternative to the foregoing, Marathon Oil Company might consider the feasibility of changing the name of the principal on Bond No. 60 24 496 to Marathon Oil Company and filing an additional rider assuming all liability outstanding on the present Marathon Bond (unnumbered, apparently) with Ohio Casualty Insurance Company as principal. As the present Husky bond already contains an exploration rider, no additional rider for that purpose would be necessary.

^{1/} By decision dated July 31, 1962, BLM recognized that Ohio Oil Company changed its corporate name to Marathon Oil Company.

In an August 7, 1984, letter to the Team Leader, Northern Region, Branch of Minerals Adjudication, the CSO stated that it objected to the outright termination of Marathon Petroleum's bond No. 554979-1. The CSO requested that Marathon Petroleum furnish it with a list of Federal oil and gas leases in which Marathon Petroleum and its predecessors held record title, operating rights, or the status of an approved operator as of January 18, 1952. In the alternative, the CSO proposed to add Marathon Petroleum as co-principal to the Marathon Oil bond.

In a letter to the CSO, dated October 23, 1984, Marathon Oil submitted three riders to Marathon Oil's blanket nationwide oil and gas bond No. 2279791-1. The riders were (1) an exploration rider; (2) a rider making Marathon Petroleum co-principal with Marathon Oil; and (3) a rider wherein Marathon Oil expressly assumed liability of Husky's blanket nationwide oil and gas bond No. 6024496. Marathon Oil requested that BLM release Marathon Petroleum's bond No. 554979-1 and Husky's bond No. 6024496.

In a January 4, 1985, memorandum to the Eastern States Office (ESO), the CSO stated that if the three riders to the subject bond were included in Marathon Oil's nationwide bond it would have no objection to the termination of the Marathon Petroleum bond and the Husky bond. The CSO noted that "there may be some issue as to the amount of liability attributed to Marathon Oil Company bond or the Marathon Petroleum Company bond concerning a dispute over alleged royalty deficiencies in Alaska."

Subsequently, the ESO notified the Alaska State Office (ASO) of the concern raised by the CSO regarding the Alaska royalty dispute. In a May 29, 1985, memorandum, the District Manager, Anchorage District Office, explained to the State Director, ASO:

In view of recent Federal Court/Appeals Court litigation between Marathon Oil Company and the U.S. Government, we recommend opposing the termination of Marathon's Nationwide Bond coverage unless it were replaced by another bond or rider which would cover Marathon for their Alaskan oil/gas leases, production operations, and their agreement to repay the underpayment of royalties, which at present is in excess of 20 million dollars.

We recommend that Marathon either add another rider or acquire a replacement bond of a minimum of \$500,000 in order to comply with the proposed regulations concerning bonding requirements.

We further recommend that a stipulation be included to clearly state that Marathon's Bond No. 554979 or its replacement shall be liable for the underpayment of royalties on its Alaskan leases as well as its Alaskan leasehold operations.

This memorandum was forwarded to ESO and by decision dated August 15, 1985, the ESO ordered Marathon Oil "to comply with the Alaska and Colorado Office's requests." ESO's decision provides as follows:

In response to our April 15, 1985 request for review of the three bond riders affecting Marathon's bond, the Alaska State Office (ASO) has replied:

"...we recommend opposing the termination of Marathon's Nationwide Bond coverage unless it were replaced by another bond or rider which would cover Marathon for their Alaskan oil/gas leases, production operations, and their agreement to repay the under payment of royalties ..."

"We recommend that Marathon either add another rider or acquire a replacement bond of a minimum of \$500,000..."

The ASO further requested that a stipulation be included which clearly states that Bond [N]o. 554979 or its replacement will be liable for the underpayment of royalties in its Alaskan leases and its Alaskan leasehold operations.

In addition, the Colorado State Office objected to the acceptance of the rider assuming liability on the Husky Oil Company's bond [N]o. 60 24 496 unless the rider extends coverage to exploration operations.

In its statement of reasons (SOR), Marathon Oil contends that the ESO erred in two respects "[i]n requiring, as a precondition to the termination of the Marathon Petroleum bond, that Marathon Oil increase its nationwide bond to \$500,000 and agree to a stipulation 'which clearly states that Bond No. 554070 [Marathon Petroleum's bond] or its replacement will be liable for the underpayment of royalties on its Alaskan leases and its Alaskan leasehold operations' * * *." First, Marathon Oil argues that the ESO "improperly invaded" the jurisdiction of the U.S. District Court for the District of Alaska as reflected in Marathon Oil Co. v. United States, 604 F. Supp. 1375 (D. Alaska 1985). By order dated May 1, 1985, the District Court directed Marathon Oil to calculate and pay royalties on the natural gas produced from its Kenai Unit leases in accordance with the net back theory of valuation. See 604 F. Supp. at 1386-87. 2/

Marathon asserts that on June 3, 1985, it paid additional royalties and interest amounting to \$9,111,927.42, and "has continued to pay current royalties on the production in dispute based on the methodology set out in the court's decision" (SOR at 7). Marathon Oil concludes that "BLM's assertion that there is an underpayment of royalties on Alaska leases in excess of

2/ The District Court's ruling that the Minerals Management Service could properly direct Marathon Oil to use the net back method of calculating royalties was affirmed in Marathon Oil Co. v. United States, 794 F.2d 1461 (9th Cir. 1986), cert. denied, ___ U.S. ___, 107 S. Ct. 1593 (No. 86-1006, Mar. 23, 1987).

\$20 million is simply wrong. All outstanding royalty demands on Marathon's leases have been met." *Id.*

Second, Marathon Oil maintains that the ESO erred in requiring it to increase its nationwide bond to a minimum of \$500,000 based upon proposed regulations concerning bonding requirements. Marathon Oil contends that "until the proposed regulations are duly promulgated by BLM, they are of no force or effect, and the current nationwide bond limit of \$150,000 remains in effect" (SOR at 8).

In a November 14, 1986, supplemental SOR, Marathon Oil states that in a Department of the Interior document filed on September 29, 1986, in Marathon Oil Co. v. United States, Civ. No. A83-208 (D. Alaska), the Department agreed that Marathon Oil had overpaid royalties on the production in question by a minimum of nearly \$6,000 for the time period involved. In the document entitled "Federal Defendant's Final Determination of Royalty Value," the Department states at page 31: "Thus, MMS (Minerals Management Service) has determined for the period April 1, 1983, thru June 3, 1985, Marathon has paid \$5,785.92 more in royalties (plus accrued interest) with its Accounting and subsequent payments than the amounts actually due for this period." Marathon argues that "it is clear that the Department fully agrees that Marathon has overpaid royalties; therefore, BLM's decision on the size of the bond, which was premised on the underpayment of royalties, must be reversed."

BLM did not submit an answer to Marathon's SOR or supplemental SOR.

[1] The authority of BLM to increase the amount of a bond is found at 43 CFR 3104.5, which provides: "The authorized officer may elect to increase the amount of any bond to be issued or any outstanding bond when additional coverage is determined appropriate." The conditions under which this authority may be implemented were addressed by the Board in Pardee Petroleum Corp., 98 IBLA 20, 22 (1987):

Bonds are required by BLM to insure full compliance with all the terms and conditions of the Federal lease. Forest Gray, 88 IBLA 64 (1985); Cf. R. K. Teichgraeber, 96 IBLA 249 (1987); O.R. Weyrich, Jr., 49 IBLA 347 (1980) (an oil and gas lease bond may not have its period of liability terminated until all the terms and conditions of the lease have been satisfied). Thus, whenever circumstances justify a conclusion by BLM's authorized officer that the previously set bond amount is insufficient to insure full compliance, 43 CFR 3104.5 authorizes the officer to increase the bond amount.

We agree that it was error for the ESO to require that Marathon Oil comply with the ASO's recommendations by "either add[ing] another rider or acquir[ing] a replacement bond of a minimum of \$500,000 in order to comply with the proposed regulations concerning bonding requirements" (ASO's letter of May 29, 1985). The proposed regulation, set out at 50 FR 18614 (May 1, 1985), would have increased the minimum bonding amount for

leases or operators nationwide from \$150,000 to \$500,000. ^{3/} BLM is without authority to base a bond increase on a proposed rule. Until this regulation is promulgated in accordance with the Administrative Procedure Act, 5 U.S.C. || 551-559 (1982), it does not have the force and effect of law. See Shell Offshore, Inc., 96 IBLA 149, 171, 94 I.D. 69, 82 (1987).

Moreover, ASO's recommendation "that a stipulation be included to clearly state that Marathon's bond or its replacement shall be liable for the underpayment of royalties on its Alaskan leases as well as its Alaskan leasehold operations" was based upon an erroneous assumption. The document submitted by Marathon Oil entitled "Federal Defendant's Final Determination of Royalty Value," discussed supra, indicates that Marathon Oil overpaid royalties. We also note that the document was issued by the Director, MMS, with a concurrence by the Assistant Secretary--Land and Minerals Management, who stated that the determination was the final decision of the Department. In its SOR, Marathon Oil stated that it had rendered the accounting ordered by the District Court and had paid the royalties due as of that date, which was October 15, 1985. We are persuaded that Marathon Oil actually overpaid royalties for the period for which the ASO and the ESO alleged Marathon Oil to have underpaid royalties.

In addition, the ESO decision dated August 15, 1985, directed Marathon Oil to comply with the conditions specified in the CSO's memorandum dated January 4, 1985. We agree with Marathon Oil's argument, set forth below, that the ESO apparently misread the CSO's memorandum:

This error is apparently due to the Eastern States Office's misreading of CSO's January 4, 1985 memorandum. Therein, CSO stated that it "would object to the acceptance of the rider assuming liability on the Husky Bond unless the rider extending coverage to exploration operations is simultaneously accepted. If, however, you accept these two riders and defer acceptance of the other [i.e., the rider making Marathon Petroleum a co-principal on the Marathon Oil bond], we would have no objection" (emphasis added).

Thus, CSO recommended a simultaneous acceptance of the tendered exploration and assumption-of-Husky-liability riders. Why that recommendation was rejected by the Eastern States Office is unexplained. Even more perplexing is what more Marathon Oil

^{3/} The \$150,000 surety bonds which are the subject of this appeal appear to have been issued pursuant to 43 CFR 3104.3(b), which provides: "In lieu of general lease and drilling bonds, operator's bonds or statewide bonds, lessee or operators may furnish a bond in an amount of not less than \$150,000 covering all leases or operations nationwide." We note that it does not appear that the proposed rule amending this regulation was ever adopted.

must do "to comply with the . . . Colorado State Office's request", as instructed by the August 15 decision.

(SOR at 6 n.1).

Our review of the record indicates that Marathon Oil is correct in its assertion that it has already complied with the recommendations set forth in the CSO's memorandum. If Marathon Oil's three submitted bond riders are legally sufficient, BLM should accept them. ^{4/}

[2] As to the termination of the bonds for Husky and Marathon Petroleum, 43 CFR 3104.8 provides: "The authorized officer shall not give consent to termination of the period of liability of any bond unless an acceptable alternative bond has been filed or until all the terms and conditions of the lease have been met." We conclude that, assuming the above referenced bond riders are legally sufficient, Marathon Oil has provided an acceptable replacement bond and that the bonds for Husky and Marathon Petroleum should be terminated.

Finally, we note that our holding in this case does not preclude BLM from increasing Marathon Oil's bond to ensure payment of royalties that became due during the pendency of this appeal or will become due in the future. A conclusion by BLM that Marathon Oil's bond is insufficient to ensure full compliance with the terms and conditions of the lease must be justified by the circumstances. See Pardee Petroleum Corp., supra at 22. Any determination adverse to Marathon Oil shall be appealable to the Board.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed and remanded for further action consistent with this decision.

John H. Kelly
Administrative Judge

We concur:

Franklin D. Arness
Administrative Judge

Bruce R. Harris
Administrative Judge

^{4/} We note that the record does not contain copies of the three executed riders.

